

***United States Court of Appeals  
for the Second Circuit***



**APPELLANT'S  
BRIEF**



# 75-5013

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## United States Court of Appeals

FOR THE SECOND CIRCUIT

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In the Matter  
of

STANNDCO DEVELOPERS, INC.

Motion of Amadori Construction Co., Inc. to modify stay  
of proceedings in the New York Supreme Court, Erie  
County v. Stanndco Developers, Inc. and Travelers In-  
demnity Company for foreclosure of mechanics lien.

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APPEAL FROM ORDER DENYING VACATION OF STAY  
BK 74 282

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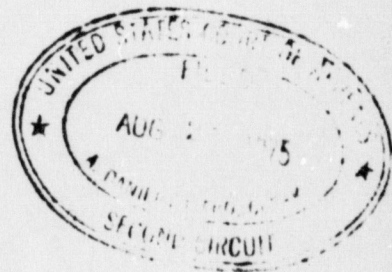
### PLAINTIFF'S BRIEF

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## I

## ISSUE FOR REVIEW

Whether a court of bankruptcy should vacate a stay of a state court action against the Chapter X Debtor and the surety on a mechanics lien discharge bond upon the offer of plaintiff to obtain no personal judgment against Debtor ?

## II

## STATEMENT OF THE CASE

On February 5, 1974 the Debtor, Stanndco Developers, Inc, filed a petition in the U.S. District Court Western District of New York under Chapter X of the Bankruptcy Act. (App. 1). On September 20, 1973, four months and sixteen days prior thereto, plaintiff, Amadori Construction Co, Inc, filed a mechanics lien of \$11,500 in Monroe County Clerk's office against real property of the Debtor situate in Monroe County. (App. 18). On October 1, 1973, four months and four days prior to the Petition the Debtor effected a release of this mechanics lien upon the filing of its mechanics lien release bond of \$13,000 upon which Travelers Indemnity Company was surety. (App. 15, 23). To effect this release the Debtor used \$13,000. of its own money. (App. 23-25).

On November 7, 1973, approximately 3 months before filing of the petition under Chapter X said plaintiff had begun an action in Supreme Court State of New York for foreclosure of this mechanics lien against the Debtor and the surety. (App.8)

On February 5, 1974, upon the filing of the petition in the U.S. District Court Western District of New York, that court issued an ex parte stay of all actions against the Debtor. (App.8)

On or about February 4, 1975 plaintiff filed a complaint in the Bankruptcy Court setting forth the foregoing facts and sought an order of the Bankruptcy Court to permit it to proceed to judgment in the state court action against the Debtor's co-defendants in the state court action without any personal judgment against the Debtor or its Trustee. Without objection, the District Court treated the complaint as a motion to vacate the stay. (App.20)

The answer of the Trustee, (App.21) did not traverse any of the allegations of the complaint below. Its Answer is one of confession and avoidance that to permit the relief demanded would effect a preference. It attached the affidavit of an officer of Debtor that to effect the release of the mechanics lien it paid \$13,000 of the Debtor's money for an irrevocable letter of credit in favor of the surety. (App.23-25).

An order was entered May 23, 1975 denying relief to plaintiff on the ground that to grant it would effect a preference to plaintiff over other mechanic lienors. (App. 26-8) A timely notice of appeal from this order was filed June 6, 1975. (App.29)

## III

ARGUMENTSUMMARY

The Bankruptcy Act is solely for the benefit of Debtor. Section 16 of the Act provides that the liability of a surety for a Debtor or Bankrupt shall not be altered by a discharge of such Debtor or Bankrupt. Section 16 is applicable to proceedings under Chapter X. The uniform construction of section 16 and its predecessors under prior bankruptcy acts by the U.S. Supreme Court, this court, other U.S. Courts of Appeal and state courts of last resort is: a creditor may not be hindered from prosecution of an action against one jointly liable with the Debtor or Bankrupt and to effect this purpose such action is permitted provided a perpetual stay of execution is rendered in favor of the Debtor or Bankrupt. Accordingly plaintiff was entitled to the relief sought as a matter of right.

## POINT I

WHERE OFFER IS MADE TO SEEK NO PERSONAL JUDGMENT  
AGAINST DEBTOR BUT ONLY AGAINST HIS SURETY SECTION  
16 REQUIRES VACATION OF STAY OF STATE COURT ACTION  
AGAINST DEBTOR AND SURETY

THE ARGUMENT FROM PRINCIPLE

Section 16 of the Bankruptcy Act provides:

"The liability of a person who is a co-debtor with, or guarantor or in any manner a surety for a bankrupt, shall not be altered by the discharge of such bankrupt."

Section 16 applies to proceedings under Chapter X of the Bankruptcy Act. All provisions of Chapters I through VII of the Bankruptcy Act apply to proceedings under Chapter X of the Act except sections 23, 57h and n, 64 and 70f. (Bankruptcy Act 102, 11 U.S.C. 502). For purpose of such application provisions relating to bankrupts shall be deemed to relate also to debtors. (Bankruptcy Act 102)

The mechanics lien in the case at bar was impervious to defeat under the Act for two reasons:

(1) It was created more than 4 months before the petition was filed and hence is outside the provisions of section 67a(1) and (2) of the Bankruptcy Act proscribing liens created within 4 months of bankruptcy and

(2) It was a mechanics lien. By express provision of section 67b of the Act mechanics liens even created within 4 months of bankruptcy are valid against the Trustee and neither section 67 nor section 60, preferences, apply thereto.

This mechanics lien was plainly not a preference. It was created more than 4 months before bankruptcy. The order appealed from appears plainly wrong in holding that it was. No other mechanic lienors could have any objection to the relief sought. If there were any mechanic lienors against the premises specifically involved, and none are alleged in the answer, their liens are also impervious to attack even if perfected within 4 months of bankruptcy by express provision of section 67b of the Act. If preference for mechanic lienors there be it is a preference created by the Bankruptcy Act and required to be respected. No mechanic lienors against other premises have any cause for objection in view of the exception created by section 67b of the Act. They are entitled to look to the security of their mechanics liens against such other property.

The real property against which the lien was filed is, by force of the mechanics lien release bond, free and clear of that mechanics lien and fully available for consummation of any plan of reorganization that the Debtor may propose. So continuation of the stay is not even theoretically necessary for reorganization of the Debtor.

There is as much or as little reason for the Reorganization Estate to stay the state court action for the enforcement of a mechanics lien perfected more than four months before filing of the Petition as there is to attack the transfer of \$13,000 to the surety more than four months before bankruptcy. Both transfers or liens are impervious to attack under section 67 of the Act because effected more than 4 months before filing of Petition.

The transfer of \$13,000 to the surety was more recent than the mechanics lien. Yet the Debtor has not sought to have that transfer voided under section 67 of the Act.

The plain language of section 16 of the Act requires that the mechanic lienor be permitted to pursue his remedy against the surety unembarrassed by the Reorganization of the Principal, the Debtor herein.

The whole purpose of a mechanic lien release bond would be defeated if the bankruptcy or insolvency of the principal stayed an action against the surety. A mechanics lien creates an interest in real property of the debtor. A mechanics lien release bond dissolves the lien. The consideration for the destruction of that interest in real property is the unsecured obligation of a solvent surety. If the right of recourse against the surety is lost or postponed by the insolvency of the principal, the bond would be of little value.

Sections 16 and 67b of the Bankruptcy Act recognize this fact of life and provide that action against the surety can proceed without regard to the solvency or insolvency of the Principal.

THE ARGUMENT FROM AUTHORITY

It was early settled by the U.S. Supreme Court that actions against a bankrupt and its surety must be allowed by the Bankruptcy Court to proceed to judgment in another forum. The practice was approved of the permission for judgment to be entered against the bankrupt with a perpetual stay of execution provided to protect the bankrupt and his discharge in order that formal requisites of the state court might be satisfied in imposition of surety liability. It was this practice that the plaintiff sought and was refused in the case at bar.

Wolf v. Stix 99 U.S.1,25 L.Ed. 309

Hill v. Harding 130 U.S.699.9 S.Ct. 725,32 L.Ed.1083

Although decided under the Bankruptcy Act of 1867 the language of that Act did not differ significantly from the parallel language of the 1898 Act. Hill v. Harding pointedly held that the surety bond took the place of the property attached and action vs the bankrupt and the surety allowed with a perpetual stay of execution against the bankrupt provided.

Hill v. Harding supra was cited and followed in Grand Union Equipment Co, Inc v. Lippner 167 F.2d.958(C.A.2,1948). At least two other decisions of this court hold that a state court action against the Debtor's surety or affiliate can not be stayed by the Reorganization Court. In re Nine North Church St, Inc 82 F. 2d 186(C.A.2,1936), In re Prudence Bonds Corp 79 F.2d 212 (C.A.2, 1935) In Nine North Church St supra the surety had guaranteed bonds of Debtor's predecessor. Action against the surety had been begun.

Reversing an injunction against the continuation of the action against the surety this court held at page 188 of 82 F.2d:

"If the certificate holders collect on their guaranty, then Maryland will have a claim against the debtor. The reduction of this claim may be essential to a reorganization of the debtor. If it takes place, the debtor will be relieved by the reduction. Maryland will no doubt be dissatisfied since it must bear the burden of the reduction. But that is as it should be. Maryland assumed the guaranty and must now be held to it. To allow a guaranty to be modified every time the principal debtor found itself in financial difficulties would be to make a guarantor's obligation nominal only. The very purpose of, and only value in, a guaranty is as a protection against the principal's inability to pay. Without a reorganization of the guarantor and a showing that its financial conditions justify relief from its obligations, the contract between the obligees and the guarantor is inviolate.

..... Section 16a of the Bankruptcy Act, 11 U.S.C.A. 34, expressly reserving a creditor's rights against the guarantor of a discharged bankrupt's debt, shows that an alteration of the guarantor's liability is not conceived to be a necessity to a discharge of a bankrupt."

Grand Union Equipment Co, Inc v. Lippner 167 F.2d 958 (C.A.2, 1948) citing and following Hill v. Harding supra approved the vacation of a stay of proceedings against the Debtor for the limited purpose of taking judgment against the Debtor with a perpetual stay of execution in order that judgment could effectively be taken against the surety.

UNION TRUST CO OF ROCHESTER v WILLSEA 275 N.Y. 164 is typical of numerous state court decisions, that discharge of a Debtor or even receipt of a Reorganization dividend does not alter or diminish the right of the creditor to proceed against the surety of the Debtor. A few other decisions to the same effect by State courts of last resort are:

BURLING v SCHROEDER HOTEL CO 238 Wis 17  
ALLEN v KAPLAN 255 Md. 409

Even a lien secured within four months of bankruptcy and bonded by an independent surety is immune from a stay of an action against the surety.

IN RE GENERAL STEEL TANK CO 478 F.2d 294 (C.A. 4, 1974).

As noted above, page 1, the mechanics lien was created more than four months before the filing of a Petition in Reorganization and the Debtor gave present value of \$13,0000.00 more than four months before reorganization to dissolve the lien and substitute the surety bond in its place. As further noted above, page 4, under section 67b of the Bankruptcy Act mechanics liens even those arising within 4 months of the filing of a petition under Chapter X are valid against the Trustee. This creates a special exception to section 67's invalidation of liens obtained within four months before the filing of the petition.

Since, under section 16 of the Act, rights against Third parties are unaffected by the filing of a petition and the case law clearly holds that actions against such Third Party and the Debtor must be allowed to proceed with a suitable stay of execution on the judgment against the Debtor, no reason appeared in the answering papers of the Debtor why such rule should not be applied in the case at bar.

The only way in which the Debtor can possibly get back its \$13,000.00 is by trial of the action against the surety in the State Court. If the surety wins its action there, the Debtor will get back its \$13,000.00. So long as the State Court action is stayed, the Reorganization Court will never know if the Debtor owns or does not own his \$13,000.00. Without knowing this, a Plan of Reorganization can never be implemented. Certainly, no reason appeared in the answering papers for continuation of the stay and the perpetuation of this \$13,000.00 in limbo.

HANDELMAN v OLEN 53 Misc 2d 566; 279 N.Y.S. 2d 48 citing and following HILL v HARDING supra held that the law of New York provides for an action being allowed against the surety and the insolvent Debtor with a stay of execution against the Debtor.

## CONCLUSION

The order appealed from should be reversed and an order entered authorizing continuation of the pending action in Supreme Court State of New York for foreclosure of the mechanics lien created more than four months before Petition and bonded more than four months before Petition.

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AFFIDAVIT OF SERVICE BY MAIL

State of New York )  
County of Genesee ) ss.:  
City of Batavia )

RE: In the Matter of Stanndco  
Developers  
Docket No. 75-5013

I, Leslie R. Johnson being  
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